

## K. PROCESSING

### **WHAT IS PROCESSING?**

Each year, schools throughout the nation receive millions of dollars' worth of donated food for their meal service operations from the U.S. Department of Agriculture (USDA). USDA buys the food under price support and surplus-removal legislation and offers it to recipient agencies through the Food Distribution Program of the Food and Nutrition Service. While some donated foods provided by USDA are purchased in ready-to-use forms, such as canned fruits or vegetables; other donated foods are provided in forms or quantities that may not be easily used, such as frozen whole turkeys. In order to make efficient use of these foods; many recipient agencies have turned to the food processing industry to convert the USDA donated foods into more convenient and usable forms.

Through processing, recipient agencies can economize on food costs, benefit from reductions in food preparation time and outlays for equipment, and make the most efficient use of their donated food. Processing helps recipient agencies provide more varied and higher quality meals, reduces waste in the food preparation process, and stabilizes costs through portion control. Processing enables recipient agencies to realize significant cost savings. These cost savings can be in the form of a discount in the normal commercial price or by way of a refund from the processor.

Processing has become an integral part of the day-to-day food service operations and its use will continue to increase as new menu items are

developed by industry and introduced to the American palate. The processing of donated foods must be done in accordance with the State Processing Program regulations (7 CFR Part 250.30).

## **PROCESSING AGREEMENT APPROVAL**

A Processing Agreement is a written document that authorizes a commercial food processor to convert USDA donated foods into more convenient forms. Such agreements assist School Food Authorities (SFAs) in maximizing donated foods, thereby contributing to the overall efficiency and effectiveness of their food service programs. The agreement begins on July 1 of each year and ends on the following June 30.

The concept of the Processing Agreements is that donated foods would be provided to a processor who would produce approved end-products which the SFA could obtain at a price reduced by the full value of donated foods contained in a case of each end-product.

Federal regulations permit State Distribution Agencies (SDAs) and/or SFAs to enter into agreements with commercial companies to process any of the donated foods available through USDA. Since several SFAs have similar needs, the SDA usually enters into a single state agreement under which all SFAs approved for the Food Distribution Program may participate. This eliminates the need for multiple SFAs to have identical agreements with the same processor for the same products. While any SFA may have its own agreement, such documents must conform to all Federal and State requirements and must be approved by the SDA prior to providing any donated foods to the processor.

## **APPROVED PROCESSORS AND END-PRODUCTS AVAILABLE**

The SDA will provide to the SFA at the beginning of each school year any relevant information concerning processing agreements approved by both the SDA and USDA. The information will, at a minimum, include the following and can be found on the Division of Food Distribution's Web Site at [www.kyagr.com](http://www.kyagr.com):

1. Name of approved processors.
2. Description of the approved end products and any identification codes.
3. Donated food(s) used in each end product.
4. Refund or discount per case for each donated food or, where appropriate the fee-for-service.

## **CHILD NUTRITION LABELS**

The State Distributing Agency (SDA) suggests that processors obtain a Child Nutrition Label for each end-product containing meat, poultry (except chicken parts), fish, or a meat alternate such as cheese. However, this is not a requirement at this time.

## **VALUE PASS-THROUGH SYSTEMS**

There are three basic systems used to ensure SFAs are provided the full value of donated foods contained in approved end products. These systems are known

as refund, discount, and fee-for-service. The refund and discount systems are generally used for Group B foods (cheese, milk, and peanut butter), whereas, fee-for-service is used for Group A foods (beef, pork, chicken, turkey, and frozen or canned fruit).

A brief explanation of each system follows:

**Refund** – The SFA purchases an approved end product directly from the processor or from a distributor at the full (gross) agreed-upon price. The SFA then applies for a refund for the value of donated food contained in the end product as identified in the processing agreements. Refund applications must be submitted within 30 days from date of purchase for state-approved processing agreements. Date of purchase is considered to be the last day of the month in which purchase/delivery occurred.

Processors are required to make refunds promptly upon receipt of application. Funds received by SFAs from the processors must be deposited in the school food service account. The cost of purchased food previously recorded should be reduced accordingly.

**Discount** – The SFA purchases an approved end product directly from the processor or from a distributor and is billed at a net price. The net price is determined by reducing the agreed-upon full (gross) price by an amount at least equal to the value of donated food contained in a case of approved end-product identified in the processing agreement. The billing procedure may be handled in two ways. First, the invoice would show the full price, the reduction for the value of donated foods(s) and the net price.

Under the second option, the invoice would show only the net price provided a bid or other written documentation is on file which clearly indicates that the net price shown reflects the proper value of donated food was used to reduce the full price.

**Fee-for-Service** – This method is actually a net-price system since it reflects what the processor will charge, exclusive of the value of donated food, to produce an end product containing donated food. End products obtained using this method are usually produced using USDA graders and/or inspectors who, at a minimum, certify that there was no diversion or substitution of the donated foods.

The SFA shall not pay a fee-for-service in excess of the maximum identified in the processing agreement.

## **COST EFFECTIVE PROCESSING**

### **Value of Donated Food**

The value of donated food contained in one case of end-product is determined by multiplying the quantity of donated food needed to produce one case by the established price per pound. This per-case amount is identified in the processing agreement on the end-product data schedule (EPDS) for each approved item and provided to SFAs on the Division of Food Distribution's web site.

## **Procurement Standards**

When purchasing foods for use in food service programs, the SFA must comply with Federal, State and local procurement standards. The primary purpose of these standards is to assure that open and free competition exists to the maximum extent possible. When the SDA or USDA enters into an agreement with a company to process donated food(s); this does not remove responsibility of the SFA to comply with the procurement standards\*. The processing agreement permits the company to receive donated foods to process into end products, but it does not establish the price, which the SFA pays. The procurement procedures used by the SFA should establish the price to be paid by the SFA for all foods, including those end products containing donated foods. The SFA, as purchaser, has the responsibility to evaluate prices received and to determine the successful bidder.

\*Contact the Kentucky Department of Education, School and Community Nutrition.

Prices for approved end products containing donated foods, which will be purchased under the refund or discount systems, should clearly state the full price (without donated foods), the value of donated foods, and the net price.

## **Determining Cost Effectiveness**

As part of the procurement activity, the SFA should ensure that acquisition of an end product containing donated food is cost effective. Determining cost effectiveness is a simple process but extremely important in demonstrating

good management, and ensuring maximum benefits are obtained from the resources expended.

To determine if purchasing a particular end product containing donated foods is cost effective, the SFA should perform the following steps:

1. The value of donated food contained in the end product should be added to the case (net) price to arrive at the total cost of the item. To calculate the cost per case of products (**except poultry**), take the number of pounds of donated food needed to make one case of end-product, x cost per pound of donated food, plus the fee-for-service equals the cost per case.

Example: It takes 25.34 pounds of beef to make beef patties, x \$1.03 (cost per pound of donated food)(beef) equals \$26.10, plus \$13.50 fee-for-service equals a total cost per case of \$39.60. The direct cost to the SFA would be \$13.50 per case plus any delivery charge from the distributor.

To calculate the cost per case of poultry products, take the number of pounds made available to the processor, x guaranteed percent for finished product, and divide by the case weight to arrive at the number of cases to be returned. Multiply the number of cases to be returned by the net case/fee-for-service price.

Example: It takes 1,000 pounds of donated food (chicken) to make chicken patties, x 84% (guaranteed percent for finished product),

equals 840 pounds, divided by 20-pound case weight equals 42 cases returned. 42 cases x \$18.40 fee-for-service equals \$772.80, plus any delivery charge from the distributor.

2. Gross (without value of donated food) prices for the same and comparable products being sold in the area should be obtained.

(NOTE: Delivery charges and all other costs should be included.) Consideration should also be given to including the SFA's cost to produce the same item, if the SFA actually has the capability for such production.

3. The total cost of the item being considered should be compared with the cost data obtained.
4. If the cost of the item (including the value of donated food) being considered is approximately the same as others, then it could be considered cost effective. However, if the total cost (including the value of donated food) of the item being considered is significantly higher, then it is not cost effective.

## **DIRECT DIVERSION VS. BACKHAUL OF COMMODITIES**

Direct Diversion is when commodities are ordered by a SDA to be shipped directly from the USDA vendor to the processor. The SFA may identify the processor and quantity of each food to be processed on the Processing Order Form. As food is ordered by the distributing agency, each SFA will be notified



of the quantity of food shipped to the processor via the Notice of Allocation (KY-FD-1) Form. At this time the SFA should contact the processor and confirm the processing request. If finished product is to be delivered by the SFA's commodity distributor, no more than three different end products can be processed. Direct Diversion is encouraged for several reasons: (1) it eliminates the risk of taking the product in and out of freezer storage several times, thus providing a more controlled environment for the donated food; (2) it results in producing a better product that has a longer shelf life than products which have been backhauled; and (3) it results in significant savings in transportation and storage.

Backhaul is when the processor transports the commodity from the SFA's or distributor's warehouse to its facility. A distributor may charge the SFA up to 90% of bid price per case for lump sum pickup by a processor. After the commodity is received in the SFA's distributor's warehouse, the SFA must contact a processor and choose their end products. The processor then initiates the process by completing a Backhaul Request Form and forwarding it to the SFA. The SFA approves the request and forwards a copy to the SDA for approval. The SDA approves and returns copies to both the processor and the SFA. The food then is transported by the processor from the SFA's distributor to the processing plant. When frozen foods are thawed, which is done when products are backhauled, a certain amount of moisture is lost from the product; this directly lowers yield of finished products to the recipient agency. Backhauling adds extra cost to the processing of the commodity. Poultry cannot be backhauled due to safety issues and the risk of contamination.

## **FOOD ORDERING**

Prior to the beginning of each school year, the SFAs are allowed to designate how many cases of product they would like to have diverted to the processor of their choice by filling out the processing order form. Prior to filling out the order form, the SFA should contact the processor/broker to determine which end products they want to order and how much product they need to send. **THIS IS EXTREMELY IMPORTANT.** If this is not calculated correctly, the SFA may get back more product than they expected or too little.

Once the donated food has been requested for processing, the SFA **must accept delivery.**

Upon receipt of all processing order forms from SFAs, the orders are totaled and truckloads are established. If there are not enough orders to make a full truck, the SDA will combine with another state to make a full truck if available. If there is not enough interest to divert product to a certain processor, the SFA is notified and given the opportunity to choose another processor.

### **Notification**

Processors are given the allocation breakdown for each SFA. The SFAs are notified of the exact amount of commodity delivered to the processor and when it was delivered via the Notice of Arrival Form (KY-FD-2). If at that time the SFA has any questions about the quantity of commodities being delivered, they should contact the SDA.

The processor must make an appointment with the SFA's distributor 24 hours in advance of delivery of the finished product(s) and also notify the SFAs of the delivery date.

The SFAs must send the Notice of Delivery of Donated Foods to Schools (KY-FD-3) to the distributor within 24 hours of notification from the processor. SFAs have 30 days free storage for processed items.

## **GUARANTEED MINIMUM RETURN**

Guaranteed Minimum Return (GMR) is one of the most important concepts in the processing of donated foods and pertains primarily to processing of meat and poultry. Simply stated, it is the minimum amount of finished end product that is to be returned to the SFA based on the amount of raw donated food supplied to the processor. All state-approved processors have a guaranteed minimum return for commodities being processed. This means when the SFA agrees to have a certain amount of pounds processed, the company representative can tell the SFA the exact guaranteed amount of cases to be returned.

To calculate the GMR for commodities other than poultry, divide the number of pounds made available to the processor by the number of pounds of donated food to make one case of end product. For example: 3,540 pounds to be processed into beef patties, divided by 25.34 pounds needed to make one case equals 140 cases GMR.

To calculate the GMR for poultry, multiply the guaranteed percentage for finished product by the number of pounds being processed and divide by the weight per case. For example: 1,000 pounds to be processed, x 84% guaranteed finished product, divided by 20 pound case weight equals 42 cases GMR.

The information needed to calculate GMR can be found on the approved end-product list on the Division of Food Distribution's Website, [www.kyagr.com](http://www.kyagr.com).

### **Over Yield and Under Yield**

If the guaranteed number of cases is not returned to the SFA, the processing company must provide the SFA with the difference. If the amount returned to the SFA from the processor exceeds the number of guaranteed cases, the excess product belongs to the SFA. The SFA must pay the fee-for-service for each case it receives.

### **COMPLAINTS ON END-PRODUCTS:**

All complaints pertaining to an end-product should be directed to the processor. If the problem can not be resolved between the R/A and the processor, then a formal complaint should be made, using the Electronic Commodity Complaint Form (KY-FD-21), which can be found on the Food Distribution web site under the National School Lunch Program, then click Forms. Please complete this form in detail and email to the Processing Specialist. We will then communicate with the Processor and USDA on the complaint and will keep the R/A informed of the procedures.